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AN ABSTRACT OF A THESIS

SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF DOCTOR OF PHILOSOPHY IN ECONOMICS IN THE GRADUATE SCHOOL OF THE UNIVERSITY OF ILLINOIS, 1932

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AN ABSTRACT

THE ADMINISTRATION OF MUNICIPAL FUNDS WITH SPECIAL REFERENCE TO ILLINOIS CITIES

Many of the problems of administration of municipal funds exist in cities generally, but only cities of Illinois were used as illustrative material. The subject of administration of municipal funds is a subject of prime importance not only to those persons interested chiefly in accounting procedure and practice but also to those interested in public finance. As early as 1898 a text on public finance discussed budgets, appropriations, and financial organization and administration. This treatise considered the keeping of accounts either on the basis of accrued assets and accrued liabilities or on the basis of cash receipts and cash expenditures.

The problem of administration of funds is important because of the amounts involved. The cities of New York and Chicago show a decided upward trend in both the total expenditures and the per capita revenues. The totals of "all governmental cost payments" and the per capita of "all revenues" of the fifteen largest Illinois cities, exclusive of Chicago, show as a group a gradual increase. In 1925, 1926, 1927, and 1928 the cities of over 30,000 population, of which there were approximately two hundred and fifty in the United States, expended more than the federal government exclusive of payments for retirement of debts. The percentages of total expenditures of cities of over 30,000 population to total estimated realized income of the United States are, for the years 1923-1928 inclusive, 3.18%, 3.42%, 3.55,%, 3.57%, 3.77%, 3.79% respectively.

Effective administration of municipal finances requires a close co-ordination of revenues and expenditures. This co-ordination requires careful planning and when this is done in a systematic way, it results in budget-making. The statute requires cities and villages to prepare budgets. There are only eight cities in Illinois with village form of government and six do not prepare a budget. Of twenty-four aldermanic cities, eighteen did not prepare budgets

for the 1931 municipal year. Of twenty-four cities, that have the commission form of government, only four made an honest effort toward preparing a systematic budget. Twenty cities did not prepare budgets in which one would be able to find the amounts of actual expenditures of 1930, the anticipated revenues for 1931, and estimated expenditures of the year 1931. Some reasons for the lack of budgets in cities of all types of government are: (1) incompetent personnel and (2) lack of enforcement of the statutes relating to budget-making. One direct result of both causes is incomplete records from which it would be difficult to prepare budgets.

To make an expenditure a legal transaction each city and village is expected to have passed through the vote of the city council one or more appropriation ordinances each year. The statute states "... corporate authorities may appropriate such sum or sums of money as *may* be deemed necessary to defray all necessary expenses and liabilities of such corporation, and in such ordinance *shall* specify the objects and purposes for which such appropriations are made, and the amount appropriated for each object or purpose..." In addition to the law just quoted, the city council of a commission form of government may be subject to a fine if any persons "directly or indirectly expend a greater amount for any municipal purpose than the amount appropriated for such municipal purpose..." One of the fifty-six cities studied did not pass an appropriation ordinance. However, a tax levy ordinance was prepared and passed. It was also shown that city officials have not clearly understood the distinction between a tax levy ordinance and the appropriation ordinance. In connection with the appropriation statutes we should notice the following: (1) the law concerning appropriations does not mention specific funds as general corporate, street and bridge, and library; no departments of the general corporate fund as police, fire, and street are mentioned; and no definite idea is conveyed as to how much in detail the expenditures or expenses of the various funds and departments should be itemized. (2) There is no maximum set for amounts that may be placed in the appropriation ordinance. (3) The meaning of over-expending cannot be definitely determined. Does over-

expending, as used here, mean only spending more cash than a certain amount provided for in the appropriation bill, or does the term include both spending of cash and incurring of liabilities over the amount appropriated? The latter is the proper provision and it should be so stated definitely in the statutes. And, (4) what is considered to be "the amount provided for" in an appropriation ordinance? Does that refer to each specific item of expense within a department of a fund, only to departments, or, only to funds?

Illinois cities have attempted to make expenditures remain within the legal appropriations in the following ways: (1) The amounts of some appropriation items and the totals appropriated are placed at figures much greater than the total revenue can possibly equal. (2) An item called "contingent fund" may appear in the appropriation bill. Charges that can not be entered against another item will be taken to the so-called "contingent fund". (3) Some cities have made special provision in their ordinances for the transfer of unexpended appropriation balances. In some cases such transfers have been made between funds. (4) In several cities the heads of departments will receive statements showing the amounts that were appropriated, the amount of cash expended for the various appropriations, and the unexpended balance. Often the statements prepared do not include in the expenditures column the amounts of liabilities incurred and not deducted from the appropriation amounts. Thirteen cities have made either no entries or incorrect entries on their books and therefore did not know if they were keeping within appropriated amounts.

The cash receipts belong in certain definite funds. To know which funds are affected in a particular city one must know both the ordinances of that particular city and the state statutes. The general and personal property taxes must be distributed to the proper funds on a percentage basis which must be calculated for each city on the basis of the tax levy. Only nine of forty cities make and use such a percentage calculation.

Improper classification of expenditures and lack of necessary segregation of funds exist frequently. In the cases of two funds, Police Pension and Firemen's Pension, which are required by

cities of over 5,000 and less than 200,000 population, approximately fifty-six per cent maintained the former and only fifty per cent of the cities maintained the latter. The Public Benefit Fund has been handled improperly by incurring more liabilities than can be paid. To comply with the requirements of the Water Fund a complete record of accounts of all classes must be kept and reasonable rates must be charged sufficient to pay the cost of operation and maintenance, to provide an adequate depreciation fund and to pay the principal of and interest upon all water revenue bonds. It is not possible to determine the proper rates unless a complete profit and loss statement is prepared. Of twenty-nine water plants owned by cities, only four have prepared what seem to be approximately complete balance sheets and profit and loss statements. The lack of financial statements is a direct result of incomplete information from which to prepare statements of such facts.

Many cities have lost revenue because of careless methods and lack of control over collections. In the cases of twenty-nine cities, we find that in 1930 the police magistrate kept no definite system of records and that he reported and remitted not oftener than once a month. His report was taken as given without any check or audit being made. Only eight cities and villages made a monthly check or audit of the police magistrate and justice of the peace records.

The law states in general terms that the comptroller or city clerk shall keep the records of the municipality. The statutory requirements for records to be kept by the treasurer are stated as follows: "He shall keep a separate account of each fund or appropriation, and the debts and credits belonging thereto." More explanation is necessary to understand the meaning of *account, appropriation,* and *debts.* Does the word account, as used here, mean one account or does it mean a complete record of each fund? Does the word appropriation mean departments of the general corporate fund or is it used to mean the same as fund? Does the word debts mean liabilities of the funds or was the letter "i" omitted from the word debits? Under one interpretation one would assume that the treasurer is expected to keep a complete set of accounts. That would mean an almost complete duplication of

the city clerk's record requirements. It is reasonable to expect the treasurer to keep only cash accounts for the various funds including one account for each special assessment, and the law should definitely state that requirement.

The city clerk, comptroller, commissioner of accounts and finance or any other person authorized by ordinance to supervise or keep the special assessment records should have a complete set of balanced accounts for each improvement *by installments.* Forty-two of forty-four cities do not maintain separate general ledger accounts for assessments receivable by installments and have no separate installment interest accounts. Seventeen city treasurers do not have separate cash accounts for each special assessment. In several cities the treasurer keeps no records whatsoever. The lack of correct segregation of cash balances has caused the retirement of bonds from cash that was not available for that purpose. An overdraft of over $200,000 existed in certain special assessment funds in 1931. Several cities would make a saving by following the legal requirement of issuing bonds on special assessments at par plus accrued interest.

There exists a lack of uniformity as to the practice of getting a depository bond from banks by cities and villages. Five cities received securities from depositories, the securities being held in escrow by the city officials. Six banks furnished surety bonds. Four cities accepted from their depository banks a bond which was signed by the officers and some stockholders of the banks in which the municipal funds were deposited. Fifteen cities required no depository bonds from their banks. Until 1931 the cities with commission form of government were supposed to receive a minimum of three per cent interest on bank balances. Nine such cities received no interest, one received three per cent and then paid two per cent as a service charge, five received three per cent interest, and one received two per cent. A similar variation in interest rates existed in cities with aldermanic forms of government. In two instances, funds of $300,000 and $1,070,000 respectively were on deposit, the municipality receiving no interest at all in either case. In one case the treasurer received personally two per cent on the balance of the city's deposit.

Comparatively little internal checking or continuous auditing is done in the offices of municipalities. Only a few balance sheets of the various funds are prepared by any of the officers who are in charge of keeping records. A small percentage of the cities that operate their water plants prepare complete balance sheets and profit and loss statements.

The law requires no audits, by outside parties, of any of the general funds and special assessment funds except in the case of municipalities with a commission form of government. The only other audit required by law is that which must be made when municipalities issue revenue bonds under the act providing for the purchase or building of a water plant. The accounts of the water plant are then "to be properly audited by a competent auditor." A large majority of the municipalities have some kind of an audit made. The audits are often done superficially and the results are of little value. Not all of the funds handled by some municipalities are audited. The financial statements which are prepared for a few cities are reasonably complete. Many reports of public accountants do not show the necessary financial statements.

It has been shown therefore that budgeting; appropriating; collection, segregation, deposit, custody, and disbursement of funds; and the internal and external auditing and preparation of financial statements are in general not performed according to the requirements of the law and good business practice. While in this study we have used only Illinois cities for illustrations we may not be assuming too much that such conditions exist generally. The practices of good municipal administration have a much broader application than merely to Illinois cities. Therefore, the conclusions of this chapter are of general application.

If the following changes were made and the suggestions followed, the administration of municipal funds would be improved:

(1) The budgeting laws should describe completely the proper procedure and the amount of details required in the preparation of a budget.

(2) The laws on appropriations should state how much detail is expected. They should state the necessity of appropriating by

funds and departments. No transfers should be allowed between funds and transfers between departments of a fund should be subject to council action. It should be stated that the incurring of a liability against any fund constitutes an expenditure. The total of any appropriation should not be greater than the sum of the following for *each* fund: the remaining cash balance from preceding period, the total expected revenue from the general corporate levy, the total of miscellaneous expected revenue, and the expected revenue from special levies.

(3) Only competent officials and office personnel should be chosen. There can be no assurance of the proper administration of funds unless the comptroller, the city clerk, and the commissioner of accounts and finance have a thorough knowledge of accounting procedure as it applies to the various municipal funds. The officials should also, before being allowed to enter office, know the laws which affect the methods of handling funds.

(4) The office of the comptroller, if there be one, otherwise the city clerk, and the commissioner of accounts and finance should maintain the complete general accounts of the city, including accounts of all assets, liabilities, and appropriations, The treasurer's office should maintain only accounts or records necessary to show the receipts and disbursements of cash, and the cash in the various depositories and to the credit of the various municipal funds. The latter includes each separate improvement fund.

(5) The accounts of the comptroller, city clerk, and commissioner of accounts and finance should be classified by funds. The assets, liabilities, incomes, expenses, and surplus of each fund should constitute a separate balanced group of accounts.

(6) The billing and collection of all revenues and other receipts should be recorded on numbered forms and controlled by the office of the comptroller, city clerk, or commissioner of accounts and finance.

(7) Every proposed order or contract should be approved as to whether a sufficient balance is available in an appropriation from which it may be met, and the estimated cost of the item should at

once be set up as an encumbrance against that appropriation and the free balance of the latter reduced accordingly.

(8) Records of special funds such as bond funds, special assessment funds, and pension funds, should include in separately balanced groups such accounts as are necessary to show the condition and operations of those funds.

(9) The comptroller, city clerk, or commissioner of accounts and finance should provide for a continuous audit of all financial transactions of the city and of the accounts of all officers who are required to keep records.

(10) He should submit to the city council or board of trustees at least once a month a financial report of the municipality, including the following information:

(a) The receipts, disbursements, and cash balances of each fund; which should be reconciled with a similar report from the treasurer as of the same date.

(b) A statement of the receipts classified by source and with the budget estimates shown in comparison.

(c) A statement of expenditures from each appropriation, including the amount of obligations outstanding against each such appropriation but not yet paid, and the free balance remaining unexpended.

(d) A balance sheet showing the assets, liabilities, and balances of each fund except the water fund or other utility.

(11) The comptroller, city clerk, or commissioner of accounts and finance should present at least semi-annually to the council or board of trustees a complete balance sheet and profit and loss statement of the water plant and any other utility operated by the city.

(12) The city treasurer should collect, or should receive daily from other persons who are required to collect, all moneys due the city from all sources. A reasonable rate of interest should be received on the municipal balances on deposit. Those accruals must

be added to the specific funds which earned them. He should submit to the city council or board of trustees at least once a month a statement of the receipts, disbursements, and balances of each fund and the disposition of the total cash balance of all funds. This statement should be reconciled by the comptroller, city clerk, or commissioner of accounts and finance to the latter's accounts and certified to by him.

(13) The accounts of the comptroller, city clerk, and commissioner of accounts and finance should be audited at least semi-annually by certified public accountants or public accountants. The accountant should present a balance sheet and a statement of receipts and disbursements of each fund. He should also present a profit and loss statement of the water fund and of any other utility owned by the municipality.

VITA

The author of this study, Wilbert Eugene Karrenbrock, was born in New Melle, Saint Charles County, Missouri, September 8, 1899. He received his early education in the New Melle public school and graduated from the Academy of Central Wesleyan College at Warrenton, Warren County, Missouri in the spring of 1917.

In the fall of 1917 he entered Central Wesleyan College. The following year he transferred to Washington University, Saint Louis, Missouri, in order to be able to enlist in the Student Army Training Corps. At the end of the first semester, when the military organization was disbanded, he transferred back to Central Wesleyan College, from which institution he received the degree of Bachelor of Arts in June, 1921.

In the fall of 1921 he entered the College of Commerce at the University of Illinois, from which he received the degree of Bachelor of Science in June, 1923. In February of that same year he entered the Graduate School of the University of Illinois, and received the degree of Master of Science in June, 1924. Beginning in the fall of 1923 he was an assistant in Accounting for three years and an instructor in Accounting for the succeeding six years while pursuing his graduate studies at the University.

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